REDLINING

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Redlining

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What is "redlining?"

Redlining is a term commonly understood to mean systematic refusal by a financial institution to make mortgage loans on residential property lying within certain districts -- usually older, low-income neighborhoods -- of an urban community. The word suggests the image of a city map tacked on the wall in a bank or savings and loan office, with areas outlined in red where mortgage loans are not to be made. It also suggests some kind of "gentlemen's agreement" among all major sources of home purchase or rehabilitation loan funds to follow the same geographical guidelines.

Back in 1936, the Home Owners Loan Corporation prepared a detailed survey and classification of mortgage credit risk areas in Oakland and Berkeley, California. Four classifications were employed and each of some seventy neighborhoods were color coded on an accompanying map. Areas deemed "hazardous" were colored red. The purpose of this government survey was to guide mortgage lenders in the area who were beginning to get involved with the newly-introduced FHA mortgage insurance program. In the blunt language of the times, the central criterion used to classify an area as "hazardous" for home loans was the proportion of "undesirable population."

As public interest in redlining increases, the term is acquiring a somewhat more precise and restricted definition. In the Spring of 1975 the U.S. Senate Committee on Banking, Housing and Urban Affairs reported a finding that: "There is ample documentation that credit-worthy persons are sometimes denied loans on sound homes solely because of the location of the property." (1)*

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*Numerals refer to list of selected references attached.

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How prevalent is redlining?

The Senate Committee heard testimony based on computerized studies using census tract mapping covering areas in Baltimore, Los Angeles, St. Louis, New York City and Washington, D.C. and less elaborate studies for ten other cities. Their report states that "the data ... showed a consistent pattern in which most lenders seem to be reluctant to make loans in older neighborhoods." (1) When loans were made in such areas they were likely to be "on onerous terms."

One way of measuring redlining is to compare the aggregate savings deposits made by residents of an area with the total amount of loans made by the same thrift institutions on property in that area. For example, the Senate report states that a particular financial institution in Chicago had deposits of $10.4 million from residents of redlined neighborhoods but had not made a single loan in these areas. A WALL STREET JOURNAL story in August, 1975, reported a study which showed Chicago Savings and Loan associations lend back only two cents per dollar of deposits from redlined areas. (12)

Another indication of redlining is a differential in mortgage loan terms available in certain districts. A San Francisco legal-assistance lawyer obtained data to show that mortgage borrowers in the Mission Hill area "were paying surcharges, in the form of higher interest rates, extra charges at the closing of a loan agreement, lower appraisals, and higher downpayments, amounting to more than 15 percent of the purchase price -- all because the savings and loan associations, with one exception, had decided that this was a high risk area." (4)

Despite an abundance of such information there is still substantial uncertainty about both the extent and the implications of redlining. In fact, pending Federal legislation has no object beyond merely requiring lending institutions to make data available -- on a census trace code basis -- concerning location of properties secured by loans. (1)

What kinds of neighborhoods are redlined?

According to the Senate study, redlined neighborhoods tend to have the following characteristics:

older, though well-built housing stock
middle-class or blue collar income levels
racially integrated, white-ethnic or black populations
adjacent to poorer communities. (1)

Another common observation is that areas slipping into the redlined category tend to have mostly FHA rather than conventionally financed homes.

What are the consequences of redlining?

To summarize the points that occur frequently in discussions of redlining:

- properties in these areas are hard to sell and tend to fall into the hands of "slumlords" or speculators, so that homeownership in the area declines,

- maintenance and rehabilitation are discouraged, and deterioration speeds up,

- owners not intending to move away may be forced to do so, particularly if home improvement financing is refused,

- residents may feel unfairly deprived of access to their pool of savings.

Is redlining consistent with sound management of a thrift institution?

As noted above, the HOLC conducted and published, in 1936, a SURVEY OF MORTGAGE RISK, which identified some seventy residential neighborhoods in Oakland and Berkeley, described the history of each and classified them into four degrees of mortgage risk. (15)

CREUE Research Report Number 24 - FILTERING AND NEIGHBORHOOD CHANGE - included a comparison of the neighborhood groupings in the HOLC study, in terms of average dwelling unit value in 1936 (from data in a real property inventory) and in the 1960 Census. (14) The relative ranking of A ("best"), B, C, and D ("worst") neighborhood groupings remained largely intact over the period. That is, the A neighborhoods had the highest average values in 1936 and in 1960, B areas the next highest, C lower than B areas, and D areas had lowest average values at both points in time. However, in terms of <u>percentage increase</u> in average value, the ranking was just the reverse; <u>D values</u> increased most, percentagewise, and A areas increased least rapidly. It seems clear that the upward pressure on property values in the D areas was due primarily to in-migration of minority households into Oakland who found areas A and B unavailable to them while C neighborhoods were gradually opening up. Most of this minority population was compressed in the D or "red" areas.

The clear implication is that so-called "hazardous" mortgage risk areas were in fact better security areas than the neighborhoods in which mortgage loans were encouraged by the HOLC study.

In 1971 CREUE participated in a nine-city study of inner-city housing studies, summarized in a book by Prof. Fred Case published in 1972. (16) CREUE's involvement consisted of a series of case studies of Oakland families who had been turned down for FHA or VA mortgage loans, plus a survey of selected properties in Oakland areas reputed to be "redlined." The following points emerged:

While some properties in these low-income areas had normal institutional financing, most did not -- i.e., "redlining" was apparent.

Institutional lenders were reluctant to make loans in such areas for several reasons, all of which represented a particular concept of "risk."

One reason that certain neighborhoods suggest excessive "risk" to lenders is that the people living there often have unfavorable credit histories, usually traceable to their minority status and general financial insecurity -- collection problems resulting from credit purchases of appliances from "credit jewelry" type stores, inability to cope with medical expenses in catastrophic illness, irregular employment, family dissolution occasioned by financial and credit problems, etc.

Another source of lender avoidance is the likelihood of extensive vandalism should the property securing a loan become vacant. Related to this is the reluctance of lenders to foreclose on loans in neighborhoods where vandalism, or at least community ill-will would likely be incurred.

It was also apparent that lenders and potential borrowers had a communication problem. Major financial institutions did so little mortgage lending in such areas that they really did not know the territory very well -- a circular problem but a real one.

The fear of declining property values was realistic to the extent that many of these mortgage-money deprived areas were inappropriately zoned -- having been needlessly zoned for industry years before -- or were deficient in infrastructure and public services so as to be relatively unattractive in the market. Several residential areas in older parts of Oakland lack curbs or had only wooden curbs which were badly deteriorated, so that street-cleaning could not be done efficiently, for example.

Two basic issues

Fiduciary institutions respond primarily to the needs and interests of their depositors, trying to get the best return with least risk. They do this because of the basic traditions of thrift institution management and because of the nature of public regulation of their activities; mortgage insurance is not a complete answer to this bias because default and foreclosure are not usually completely costless to the institution in the best of circumstances. (10) A lender with high default and foreclosure experience is likely to be scrutinized very carefully by regulatory agencies. So lenders would be inclined to view "greenlining" proposals -- requiring money received from depositors in a particular neighborhood to be loaned back on properties there -- as contrary to the best financial interests of those very depositors, let alone depositors from other neighborhoods.

Another issue is the distinction between relative and absolute "risk" in mortgage lending. When money is tight, lending institutions compete for loans in the "best" areas (mainly new, middle-income housing) and the supply of funds dries up for transactions in older areas, even though these areas are not likely to produce less favorable yields or earnings for depositors. Loans in low-income areas are not necessarily perceived as "bad" loans but only "less good" loans, to which greater uncertainty applies, but which would be "good enough" security areas if mortgage funds were abundant.

The idea of a risk pool

No doubt the practice by financial institutions of avoiding mortgage lending in certain residential areas contributes to the gradual deterioration of such areas. But the heart of the redlining issue is probably that loans are denied to basically creditworthy individuals because they happen to reside or wish to purchase homes in such areas. If access to credit were assured to individuals, to the extent appropriate to each person's housing requirements, probable financial future and eligibility for assistance, "redlined" neighborhoods might still exist and they would gradually empty out, but this would be a problem of less magnitude. It seems more important that credit be available to people than to areas.

As for neighborhood revitalization and preservation, a compulsory risk pooling arrangement can undoubtedly have some beneficial effect. However, public infrastructure investment and public services are also required. Financial institutions alone cannot upgrade such neighborhoods, and it may seem unrealistic to require an increase of mortgage funds unless appropriate efforts from local government are also forthcoming for these areas.

Who is making an issue of redlining?

In 1972 a Chicago group calling itself The National People's Action on Housing was organized to combat redlining. (4) Similar organizations have appeared in Boston, Milwaukee and Minneapolis-St. Paul. Their aims appear to be first, to persuade lending institutions to disclose where their deposits come from and where their loans are made among the several neighborhoods (census tracts of ZIP code areas) of the particular city; and second, to persuade institutions which have redlined areas of the city to agree in writing to allocate some fixed share of all loans to such previously avoided neighborhoods. For example, one Chicago savings and loan pledged $2.1 million in conventional loans this year for properties within neighborhoods represented by the citizens group which negotiated the agreement. (12)

While there are strictly legal arguments against redlining (see below), the most popular tactic of opposition groups is a form of organized "bank-run" or depositors' boycot, called "greenlining." After obtaining information to show that a particular bank or savings and loan gets far more in deposits from a neighborhood than it sends back in loans, the citizen group uses this information to persuade residents of the area to withdraw their deposits. If a significant proportion of these depositors go along with the boycott the lender can be forced to pay out hundreds of thousands of dollars in a few hours, a contingency for which it is not likely to be prepared. The threat of large withdrawals by a well-organized group can be sufficient to win major concessions from a lending institution. In Chicago --

> Father Ciciora (assistant pastor of St. Paul's Catholic Church on the southwest side, and president of the Citizens Action Program against redlining) is planning another raid on Crawford (S&L) and an $80-million to $100-million run on giant Tallman Federal S&L. He explains: ... The S&L's claim we are forcing them to make bad loans, but ... the financial institutions must realize that our neighborhoods come first. (3)

The CAP group in Chicago prepares for negotiations with selected lending institutions by collecting "greenlining pledges" from depositors living with redlined areas. (6)

Spokesmen for the financial institutions have sometimes expressed very low esteem for such tactics:

> Said one irritated Illinois banker: "These people don't have a legitimate issue, but they're zealots, and zealots scare the hell out of me." (3)

In fact, however, there does seem to be a "legitimate issue" in the sense of a regulatory provision which Federally chartered S&Ls -- at least -- may be violating when they engage in redlining. The language of the charters of such institutions requires that they serve as "local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of their homes." (6) From their earliest days savings and loan associations have been thought of as neighborhood credit pooling arrangements for home finance.

Where does the real estate broker stand?

In his testimony at hearings conducted this past July by a California state agency, the President of the California Association of Realtors, Richard Farrer, said that CAR actively opposes redlining "as a covert means of racial or religious discrimination." (2) He also stated that "homebuyer counseling programs are the best means of attempting to solve the problem of redlining." Such counseling would, he believes, help lower foreclosure rates and improve property maintenance in those urban areas which mortgage lenders appear anxious to avoid.

Inner-city rehabilitation programs

The borrower-by-borrower counseling approach urged by Mr. Farrer might seem to promise little toward the restoration of entire inner-city neighborhoods where redlining issues arise. In some cities such as Philadelphia, Baltimore and San Diego, S&Ls themselves have undertaken programs of encouraging rehabilitation of hundreds of homes in entire neighborhoods. (8,9) Inner-city home buyers are accorded "first priority" for available loan funds by Baltimore Federal. (9) Some of these loans are backed by the Maryland Housing Fund. HUD and the Federal Home Loan Bank Board have expressed support -- both moral and financial -- for neighborhood rehabilitation programs by lenders following the Pittsburgh, Pennsylvania scheme, called Neighborhood Housing Services, which got underway in 1968. NHS involves setting up a pool of funds for special high-risk loans so that even those home owners who could not otherwise qualify for financing can participate in coordinated area-wide rehabilitation efforts.

The problem of inner-city housing abandonment is closely related to redlining:

> Our research showed us that 1,200 abandoned houses were abandoned because of high interest rates, because of short term high risk payment schedules, because of the unavailability of mortgage loans, the unavailability of rehabilitation loans, the unavailability of conventional financing -- in short, redlining. Sellers can't sell and buyers can't buy! The houses were abandoned because of faulty FHA construction and rehabilitation, because FHA sold houses "as is" indiscriminately to speculators, because HUD sold government repossessed houses not to qualified 235 certificate holders but to "investors" and "specualtors," abandoned because counseling and necessary forebearance advocacy in human situations in today's economy were not availalbe, abandoned because of 100% insurance to the mortgage houses -- and we only have to look at Chicago's $4½ billion scandal to understand the effect of 100% insurance, abandoned because of scare tactics and quick foreclosures. These houses were abandoned because of the paucity of city services, abandoned because some absentee landlords seek capital gain off capital loss, some were abandoned because of inheritance and probate, abandoned because rehabilitation costs, requiring second mortgages, forcing the payment schedule for housing above 25% of a family's adjusted income.
>
> (statement by F. Matarrese, Chairwoman of the East Oakland Housing Committee at hearings conducted by Senator Alan Cranston in Oakland, California, August 28, 1975)

Senator Cranston has proposed new Federal legislation to deal with the problem of abandonment directly and with redlining indirectly:

> Cranston said his proposed new legislation would create a Neighborhood Corporation financed by the government which would have the power and responsibility to:

-- secure possession and ownership of abandoned houses quickly to prevent deterioration of the unit and stem the spread of abandonment in the neighborhood.

-- renovate and rent or sell abandoned units.

-- raze units and hold lots or blocks of land for redevelopment in accordance with local community development housing plans.

-- bring units it sells or rents up to local housing codes, maintain units it rents and be responsible for servicing the mortgages of the units it sells.

-- provide new money over and above any federal money coming to a community through a generally applicable program, and be able to ensure the flow of money against any budgetary cutback either by Congress or an administration.

-- operate independently and solely for solving the abandonment problem through the support of the community the corporation serves.

-- encourage lenders to cooperate with the program to forestall possible foreclosures.

(released by Office of Senator Cranston, August 28, 1975)

In conjunction with the same hearings, the San Francisco Area Office of HUD outlined a proposal -- termed "greenlining" though unrelated to depositor boycotts as in Chicago -- which would relax mortgage insurance underwriting standards for neighborhoods where there is a coordinated program of rehabilitation accompanied by community improvement of facilities and services. The latter effort ties in with planning for use of revenue-sharing funds.

California's newly established Housing Finance Agency is also likely to become actively involved in neighborhood rehabilitation programs aimed at offsetting the effects of redlining.

The State of California's new anti-redlining program

In late August, 1975 the Brown Administration in Sacramento announced a major program of using regulatory authority to dissuade State-chartered S&Ls from the practice of redlining. New regulations are to go into effect January 1, 1976, allowing time for public responses to the proposal; thus the specifics of the plan may be altered before it is put into operation. As announced in August the approach is to first require S&Ls to disclose the geographic distribution of their depositors and their loans by census tract, and second to prohibit an association from rejecting a loan application solely on the basis of the neighborhood location of the security. Associations would be required to inform unsuccessful loan applicants in writing of the specific reason(s) for rejection. Loans in previously redlined areas may be allocated among associations and protected by a new mortgage guarantee insurance fund.

A point of view

Financial institutions are competitive business enterprises, but their activities do touch upon the public interest. Depositors entrust funds to these institutions and consumers, businesses and households depend on access to credit which these institutions provide. For these reasons most business firms operating in the field of finance are publicly regulated and publicly assisted in a variety of ways. They seem reasonably entitled to public protection from "runs," for example, whether spontaneous or organized.

It is inconsistent with this public involvement for financial institutions to deny credit on "social" grounds -- because loan officers are uncomfortable or prejudiced in dealing with people of particular ethnic background, religion, age, life-style, sex or economic status. Our society expects that such semi-public agencies will consider an application for credit on the merits of its purpose rather than on the social characteristics of the applicant. That form of redlining, once so widespread as to be considered a hallmark of financial prudence, no doubt still contributes to urban housing problems. Its persistence invites further public intervention, as well as hostility from community organizations, the end result of which could be a situation which would serve no one well.

Redlining arises from other circumstances as well, essentially from the nature of a competitive industry. Lender A knows that lenders B, C and D might not be willing to make a loan in neighborhood X; if lender A goes ahead and makes the loan

to a homebuyer that buyer will ultimately have difficulty in selling the property to families that do business with lenders B, C or D. That is, the security is illiquid because of a generally prevailing belief that financing for home in neighborhood X is difficult to arrange. This is a "self-fulfilling prophecy" -- loans are scarce because loans are scarce -- but it is a situation which the individual lender cannot readily change and it represents a real drawback to the investment quality of the loan. The effect is to inhibit "normal" turnover of ownership in affected neighborhoods. Short of an elaborate and probably impractical program of indoctrination for loan officers of lending institutions, the remedy for this kind of problem is some form of guaranteed turnover financing. At best, legislative proposals such as that announced for California may move in this direction.

Another source of redlining is a more fundamental factor. Older neighborhoods diminish in market attractiveness, because of obsolescence of improvements, deterioration of public facilities and services, rising general levels of family income and other "real" factors quite apart from difficulty in arranging financing. Again, the individual lender cannot do much to reverse the general decline in market attractiveness of an entire neighborhood. That decline will further inhibit turnover, because of steadily increasing pull from newer areas, and the liquidity of investments in the affected neighborhood will diminish. It is understandable that lenders try to avoid long-term involvement in an obsolete commodity.

That raises the ultimate issue. What is the future of a particular inner-city neighborhood? Will it be publicly or privately redeveloped for other land uses? Will it be abandoned despite new public expenditures or guarantees of financing? Is it just what some new wave of households will be looking for? In the absence of pretty convincing evidence to the contrary a reasonable lender -- or homebuyer, for that matter -- is likely to assume that past trends will continue and that old neighborhoods will "fade away and die."

There are three ways to respond to this prospect. One is a massive commitment of public and private funds to particular affected neighborhoods, restoring their attractiveness despite all. The cost-effectiveness of this general concept remains to be demonstrated though there are undoubtedly circumstances in which it would work out well enough. The second is a significant enlargement of metropolitan land use controls and regulation of housing investment so that the future of each and every neighborhood in the community would be determined by a comprehensive plan effectively carried out.

The third approach is to let external factors run their course -- let the market attractiveness of the neighborhood decline if that is what is happening -- but to provide an artificial form of liquidity for property investments in the area, a buyer of last resort. There are no substantial precedents for such a scheme, except that properties in severely depressed areas often do come into public ownership through tax default or into the hands of lenders through foreclosure. The idea of "land banking" can be stretched to include inner-city land that is in need of recycling, perhaps.

The point is that mortgage lenders are not really responsible for or able to control the long-run dynamics of urban land use. Their individual responses to forces that seem to be in motion may very well aggravate those forces and create personal inequities in the bargain. But the situation itself cannot be changed in any fundamental way without much better understanding of our urban land and housing markets and some quite new form of public involvement in those markets.

October 1975 W.F. Smith

Mr. Steven Weinzimmer and Miss Jacqueline Bernier assisted in collection of resource materials for this paper.

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REGULATING REDLINING:

RECOMMENDATIONS TO THE STATE SAVINGS & LOAN COMMISSIONER

AND SUPERINTENDENT OF BANKS

Prepared by

COMMUNITY INFORMATION PROJECT

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July 1975

REGULATING REDLINING: RECOMMENDATIONS TO THE STATE SAVINGS & LOAN COMMISSIONER AND SUPERINTENDENT OF BANKS

Community Information Project, in conjunction with Western Center on Law and Poverty, has devoted four months to the study of geographical home loan discrimination in the Los Angeles area. This research, which is still proceeding, has now enabled us to begin making recommendations for dealing with the problem of redlining in the mortgage lending industry. The following is a list of recommendations for new administrative regulations which should be implemented by the State Savings & Loan Commissioner and the State Superintendent of Banks.

Western Center and Community Information Project have recently begun discussions with the Office of the Governor, and the State Department of Business and Transportation. In response to their solicitation, the recommendations contained herein have been submitted directly to them.

I. Introduction

By proceeding against redlining by way of adminstrative regulations promulgated by the Savings & Loan Commissioner and the Superintendent of Banks, one can avoid the lengthy delays involved in producing new legislation. This is possible because existing statutes, already in effect in California, give the Savings & Loan Commissioner and the Superintendent of Banks wide powers to regulate financial institutions chartered in California.

The overall powers of the Savings & Loan Commissioner stem from the mandate set forth in Section 5250 of the Financial Code, which states:

> "The commissioner is charged with the administration and enforcement of this division, and of all other laws relating to or affecting the incorporation,

organization, business, operation, merger, consolidation, dissolution, or liquidation of associations subject to the provisions of this division. The commissioner has and may exercise all of the powers necessary or convenient for such purposes."

More specifically, the Commissioner's authority to create new administrative controls and requirements governing the savings & loan industry in California is derived from Section 5255 of the Financial Code:

> "The commissioner may promulgate, amend, supplement, and revoke in whole or in part, rules and regulations not inconsistent with the provisions of this division or other laws of the state, governing procedure before the commissioner and the exercise by the commissioner of the powers, discretions, rights and privileges vested in him under this division."

The Superintendent of Banks has similar powers, under Section 215 of the Financial Code:

> "The Superintendent is responsible for the performance of all duties, the exercise of all powers and jurisdictions, and the assumption and discharge of all responsibilities vested by law in the department. He has and may exercise all the powers necessary or convenient for the administration and enforcement of the laws relating to banks and trust companies and the banking and trust business in this State. He may issue such rules and regulations consistent with law as he may deem necessary

or advisable in executing the powers, duties, and responsibilities of the department.".

II. Home Loan Investigative Agency

Our first, and most important, recommendation is that the Savings & Loan Commissioner and the Superintendent of Banks create an ongoing investigative agency within the Department of Business and Transportation, for the express purpose of monitoring redlining and associated practices throughout the State of California. This recommendation is also supported by the Los Angeles Community Coalition Against Redlining.

Our several months of research and investigation have convinced us that detecting and monitoring redlining is an extremely complex matter, requiring considerable experience in analyzing this practice. Redlining is not merely the blatant refusal of lending institutions to make conventional home loans in certain neighborhoods. Rather, it is a complicated set of practices, many of them extremely subtle, which drive down property values, increase the mortgage foreclosure rate, bring on the physical deterioration of neighborhoods, and cause a very fast turnover in property ownership, among other things.

Participating in this activity are not only the lending institutions , but also mortgage bankers and others involved in the home loan business. To the extent of their authority, the Commissioner and Superintendent need to monitor these parties as well.

Most institutions rely on these subtle practices, rather than openly declaring a policy of not lending in certain communities, simply to avoid both negative public reaction and whatever legal or adminstrative action they may be subject to. A more detailed analysis of the specific practices involved in this scheme of activity, and the reasons for it, will be contained in a study

to be released by Western Center and CIP in the near future. However, some of the more common redlining practices include:

1) Under-appraisal of Properties --

Lenders routinely under-appraise the value of real estate in redlined areas. This has a double effect on the community. On the one hand, it is an easy device for reducing the demand for conventional mortgage loans, as owners will be increasingly unwilling to sell their properties at such deflated values. On the other hand, this practice artificially depresses property values, especially in neighborhoods where owners are desperate to sell. This latter situation is common in transition neighborhoods, once a substantial number of blacks or other racial minorities have begun to move into an area. By increasingly under-appraising, the savings & loans cause panic among remaining original homeowners, who sell out cheap to speculators. They in turn resell the properties to incoming buyers at an inflated price, which is met by taking out a new mortgage, which will either be a conventional loan at higher interest than the previous mortgage, or a secure FHA- or VA-insured mortgage.

2) Shortening Payment Terms --

By requiring that new mortgages be for a substantially shorter period than in other neighborhoods, and thereby requiring larger than normal payments, lenders again have the effect of making it difficult for homeowners to sell their property at fair market values, putting sellers in a vulnerable position for speculators. It also has the effect of placing such a great burden on new buyers, in terms of meeting unusually large mortgage payments, that buyers are subsequently unable to allocate necessary amounts for upkeep and rehabilitation of the property, thereby leading to the speedy deterioration of the neighborhood. Like under-appraising, this technique is commonly employed as a means of destabilizing transition neighborhoods, and accelerating the exit of stable, long-time residents.

3) Refusing Refinancing --

By refusing to refinance mortgages, even for borrowers who have faithfully made their payments for years but have suddenly been confronted with financial difficulties, the lenders directly cause an increase in foreclosures. This would never be done in a non-redlined area, where lenders would prefer to see neighborhoods remain stable, to ensure the security of their investments. But in a redlined area, this technique is employed to reduce the ability of homeowners to maintain their properties sufficiently and to bring on defaults which could otherwise be avoided.

The advent of these practices, and other related techniques, are signals of the impending decline of communities. Unfortunately, residents of an affected community rarely realize the consequences of these practices until the situation has become so desperate as to be irreversible. It is therefore vital to detect such activities at the earliest possible moment, an assignment which requires the attention of full-time investigators with special skills. It is on this basis that we recommend the formation of a special agency to deal with such problems.

We propose that such an agency have a statewide administrator, and branches in each major city of the state. Each branch office should have a legal advisor who is experienced in mortgage lending practices and the applicable laws. More importantly, each office should have a staff of full-time investigators, divided into two units. One group should be attached to a complaint division, the existence of which should be publicly advertised, and which would be empowered to take in specific complaints from members of the public and conduct investigations. The other group should conduct its own independent investigations, utilizing such techniques as sending test "borrowers" to various savings & loans and banks to evaluate their loan-handling procedures. Such techniques have been successfully used by police bunco units to uncover various

consumer frauds in the past, and were used specifically to investigate redlining by a special investigative panel in Illinois.

Investigations which produce evidence indicating redlining or associated practices by mortgage lenders would be processed by the legal advisor in the local office. Where appropriate, evidence would be turned over to the State Attorney General or U.S. Attorney, for possible prosecution under anti-redlining laws or civil rights statutes. More commonly, the evidence would be used as a potential basis for revoking the charter or branch license of the offending institution (see subsequent section on chartering and branching). All such information produced by the investigative staffs would be made public in annual reports to be prepared by the Savings & Loan Commissioner and Superintendent of Banks (see subsequent section on Disclosure).

Such a program as this would not impose any new financial burdens upon the taxpayers of California. Whatever costs are expected to be incurred in administering this proposal, or others subsequently described herein, would be paid for by the lending institutions which would be thereby more strictly supervised. This would be in accordance with existing law. Section 5300 of the Financial Code, dealing with the financing of the operation of the Commissioner's Office, states:

> "To meet the salaries and expenses provided for in this division, for the payment of which no provision is otherwise made, the commissioner shall require every association licensed by him or coming under his supervision to pay in advance to him its pro rata share of all such salaries and expenses as estimated by the commissioner for the ensuing year."

Section 5301 further explains this assessment procedure:

> "The proportion of salaries and expenses

> to be assessed to each association shall be the proportion which its assets bear to the aggregate assets of all associations receiving licenses as shown by the latest reports of associations to the commissioner."

The Superintendent of Banks has similar powers, under Financial Code Section 270:

> "The superintendent shall annually collect pro rata from the banks and trust companies under the supervision of the department a fund in amount sufficient in his judgment to meet the expenses of the department . . ."

The costs of operating the proposed investigative agency would be covered by these statutory authorizations, because the agency would be created through the "necessary powers" of the Commissioner and Superintendent, arising from Financial Code Sections 5250 and 215, cited in the Introduction. As a result of this power to make necessary assessments to cover expenses, no legislative action is required to enact any of our proposals. Using their existing power, the Commissioner and Superintendent have full discretion to administratively raise the funds necessary to pay for the operation of monitoring mechanisms which the lending institutions have themselves made imperative by their own misconduct.

III. Disclosure

In order to prevent an increase in redlining in communities where it is already practiced, and to keep it from spreading to other areas, it is vital to have detailed data on where lending institutions are now obtaining deposits and where they are making home loans of all types. This would allow both governmental regulatory agencies and members of the public to monitor the lending patterns of individual lending institutions and the industry as a whole.

The Savings & Loan Commissioner has wide powers to require associations to make particular kinds of reports, as he sees fit, at such periodic intervals as he deems necessary. Section 8707 of the Financial Code describes this authority:

> "Each association shall make a full report in writing to the commissioner annually within 30 days after the close of its fiscal year. The report . . . shall show accurately the financial condition of such association . . . together with such statistical and other information as the commissioner may require. The report shall be in such form and detail as the commissioner prescribes. The commissioner may require such reports for any or all associations quarterly or semi-annually in lieu of annually."

In addition to certain specific reports required by law, associations may be compelled by the commissioner to make virtually any other kinds of reports deemed relevant to the regulation of the industry. Section 8708 of the Financial Code states:

> "Each association shall make any further reports which the commissioner requires, in such form and as to such matters relating to the conduct of the business of the association as the commissioner may designate."

Banks also are subject to reporting requirements, at the regulatory discretion of the Superintendent. Financial Code Section 1930 states:

> "Every bank and every trust company shall make and file with the superintendent whenever required by him a report in such

form as he may prescribe, verified by two of its principal officers, showing its financial condition and <u>such other information as the superintendent may require</u> . . ."

Because savings & loans are the principal mortgage lenders, it is especially imperative that they be required to make very complete disclosures of their lending activities. It is also for this reason that our recommendations as to disclosure are primarily directed at them. Further recommendations as to banks will be forthcoming once our investigation of them has progressed further.

Savings & loans are already required to submit to the Commissioner, in the form of a monthly loan register, data regarding the terms of individual loans, including the location of the property on which the loan was made, according to census tract number. This is in addition to the annual report and other formal reports. However, although the data is submitted to the Commissioner separated by institution, the records of the Commissioner are kept on a cumulative basis for an entire association. This makes the data useless for checking the lending pattern of an individual institution, though it does allow one to chart the lending activities of an entire association. Because the data currently maintained by the state is so limited in scope and usefulness, the data which we used in conducting our study of redlining patterns in the Los Angeles area had to be obtained surreptitiously from sources within the savings and loan industry.

There is also some information currently available on savings and loan deposits, from the Federal Home Loan Bank of San Francisco, which has certain regulatory powers over all savings and loan institutions. This data includes quarterly reports on savings held at each branch of each institution, and

is indexed by county and city.

We recommend that, whatever records are required to be kept by the associations, or to be submitted to the Commissioner, should be completely open to public inspection. Copies of all such reports ought to be required to be maintained at all offices of the Savings & Loan Commissioner or Superintendent of Banks, and at all institution offices. While each branch should be required to keep records only on its own respective activities, the principal office of the association should be required to keep records both of its own individual activity, and of the activities of each of its member institutions.

In order to fully monitor redlining, even at the most obvious level, it is necessary to have data on both deposits and loans, coded geographically, and this kind of data needs to be kept both as to individual loans and in more aggregate forms. The individual loan data which we feel ought to be kept on record, and reported regularly, is already outlined in proposed state legislation now pending (SB 1003). This bill would require the keeping of public records indicating savings on account, amount and types of loans made, and demographic data on the borrowers. We also support a provision of the bill which injects the concept of the "primary service area" into record-keeping to make it possible to determine whether an appropriate proportion of loans are being made in the area from which most deposits originate.

In addition to individual loan data, it is vital to have the kind of aggregate data which allows easy determination of overall loan patterns, especially as they are related to deposit sources. We believe that the records required to be kept at each institution should contain the following data:

-- total balance of savings accounts;

-- number of savings accounts, and average balance;

-- total savings deposits from primary service area;

-- total number and value of conventional home mortgages;

-- total number and value of conventional home mortgages in the primary service area;

-- total number and value of conventional home improvement loans;

-- total number and value of conventional home improvement loans in the primary service area;

-- total number and value of FHA and VA-insured home mortgages;

-- total number and value of FHA and VA-insured home mortgages in the primary service area;

-- total number and value of FHA and VA-insured home improvement loans;

-- total number and value of FHA and VA-insured home improvement loans in the primary service area.

Each category of aggregate data not keyed to the institution's primary service area should be additionally broken down by census tracts, for convenient mapping of loan patterns. All of this data should be required to be updated monthly at each institution, and reported by each association to the Commissioner on a quarterly basis.

Mere disclosure of this data is not sufficient, however. The Savings & Loan Commissioner should be required to conduct annual audits of the information recorded by each association. Once the accuracy of the data is verified, the Commissioner should prepare an annual report, for public distribution, analyzing deposit and loan patterns throughout the state, accompanied by maps indicating concentrations of conventional home loans. The report should also contain any significant information produced by the proposed Home Loan Investigative Agency.

There are a few more items of information which need to be disclosed for the purpose of monitoring redlining practices.

A principal one is the amount of money in its potential loan pool which each institution sets aside through "forward commitments." A forward commitment is a predesignation of a certain sum of money, to be lent to a particular borrower, usually a large and regular customer such as a real estate developer. The effect of utilizing forward commitments is to reduce the potential loan pool which is available for home loans substantially, since forward commitments often make up a sizeable share of the funds available for lending at any given time. This undercuts the argument of many redliners that they have insufficient funds to meet the demand for conventional home loans in their own locales, since at the same time they are making large development loans elsewhere. Each institution should, therefore, be required to disclose the number, individual amounts, and aggregate amount, of its forward commitments, at the start of each fiscal year, along with the purpose to which each committed loan is to be put.

Another important item of information is the default rate which each institution is suffering in each category of loans. This is highly relevant to determining the validity of savings and loan claims that certain kinds of loans, in certain communities, are excessively high-risk, thus justifying redlining. It is therefore essential to have disclosed the number, percentage, and aggregate value of both conventional loans and FHA or VA-insured home loans on which borrowers default. Like the other data described above, this should be kept in public record form, updated monthly, and reported to the Commissioner quarterly. It should also be differentiated as relating to inside or outside the primary service area of the individual institution, and should be broken down by census tract.

A final essential category of information deals with refinancing of existing conventional mortgages, since a sudden decline in the willingness of an institution to refinance mortgages

in a given area is an early sign that the community is being redlined. It is necessary to have disclosed the number and total value of mortgages refinanced in the reporting period, as well as the proportion of the loan portfolio of the institutions which these loans represent. The data should also be separated according to loans inside and outside the primary service area, and further broken down by census tracts.

IV. Chartering, Licensing, & Branching

An ideal opportunity for imposing specific operating requirements on an institution exists at the time that it is seeking its original charter, and at subsequent time at which it is seeking an annual license or new branch licenses.

As to the issuance of a savings and loan association charter, Sections 5500 *et seq*. of the Financial Code set forth the procedures for this. Section 5513 specifically describes the grounds on which the Commissioner may reject an application:

> "The Commissioner may refuse to execute his certificate of approval, if upon his examination and investigation, he finds any of the following . . .
>
> (e) That the public convenience and advantage will not be promoted by the formation of such association."

Furthermore, before making this determination, the Commissioner is required, under Section 5511 of the Financial Code, to hold a public hearing. The statute states:

> "Before issuing a certificate to a proposed association, the commissioner shall hold a hearing at the time and place specified in the notice required by Section 5510. Any person may appear at such hearing in person

or by agent or attorney, and orally or in writing show cause why such certificate should not be issued upon any relevant ground . . ."

Therefore, there already exists an opportunity for the public to challenge the granting of charters to new institutions which intend to locate in theretofore redlined areas, and which it is believed will merely add to this practice. There is, however, a need for better notice procedures, since Financial Code Section 5510 currently only requires that other associations in the state be informed of the hearing.

Challenging annual licenses is somewhat more difficult. Section 5550 of the Financial Code sets the requirement for the procurement of an annual license, and Section 5553 conditions the issuance of the license upon the payment of the annual assessment computed by the Commissioner, described previously. While the statutes contain no provisions for challenging an association license application, the code does provide, in Section 5554, for the revocation or suspension of licenses:

> "The commissioner may after due notice and hearing revoke, or suspend for such period as he determines, the license of any association . . . which willfully violates any provision of this division."

Presumably, this last statute covers associations which violate regulations promulgated pursuant to the referenced statutes.

Branching, i.e., the licensing of separate places of business of an association, apart from its principal office, is subject to theoretically greater public control and input. Section 6002 of the Financial Code, dealing with the requisite conditions for the Commissioner to issue branch licenses, states:

> "If the commissioner is satisfied that the

> operation of the proposed branch is in the interest of such association, that the area where the proposed branch is located is not adequately served by one or more existing association or federal savings and loan associations, that such association's financial program is sound, and that <u>the public convenience and advantage will be promoted by the operation of such branch</u>, he shall issue a license for the proposed branch."

The public even has an opportunity to challenge any branch license application, under Financial Code Section 6005:

> "<u>Before issuing a branch license, the commissioner shall hold a hearing</u> at the time and place specified in the notice required by Section 6004. <u>Any person may appear at such hearing in person or by agent or attorney, and orally or in writing show cause why the branch license should not be issued upon any relevant ground</u>."

Unfortunately, the "notice required by Section 6004" only demands that the Commissioner notify all the other savings and loan associations in the state. One necessary change, therefore, is the creation of better notice procedures on behalf of the general public, e.g., requiring that notice of these hearings be published in a newspaper of general circulation, and that it be posted at all offices of the Savings & Loan Commissioner. Without changing existing statutes, the Commissioners could administratively mandate these additional notice requirements.

Better notice of branch application hearings, and the

establishment of similar hearings to obtain public input regarding charters, would do much to promote greater accountability of savings and loan institutions to the public. However, more is needed, since the public does not generally have the resources to investigate the record of existing institutions which are seeking to open new branches, or the potential impact on the community of a new institution which is seeking a charter.

The problem could be remedied by requiring that each applicant for either a charter or a branch permit prepare a report called a "Neighborhood Impact Statement." This document would be much like the environmental impact report which developers are required to submit in order to obtain approval for new construction projects. The statement would be an analysis of the expected impact which the new institution would reasonably be expected to have upon the community in which it proposed to locate, taking into account such factors as the need for another savings institution in that neighborhood and the demand for home loans in the area. More importantly, the statement would contain an anaylysis of the general financial needs of the community, especially the primary service area, and a commitment from the proposed institution to take affirmative steps to deal with those needs through its lending program. Like an EIR, this statement would be subject to review by a special staff within the Commissioner's office, and could be publicly challenged at a hearing required to be held before the application could be approved. Also like an EIR, the statement would be subject to legal challenge as to its sufficiency and credibility.

The remaining problem is that an institution could still eventually evade its commitments if there is no mechanism for regular review of charters and branch licenses. At the present time, both remain in effect indefinitely, generally being subject to cancellation only for cause, as determined by

the Commissioner. The statutes contain no indication of what would constitute proper or sufficient cause for such cancellation, and there is no provision currently for public input to such a determination. This could be easily remedied by requiring regular renewal of charters and branch licenses, with the same application procedure, including the preparation of a Neighborhood Impact Statement, effective at each renewal date. Our recommendation is that such renewal proceedings be required for charters at five-year intervals, and for branch licenses at three-year intervals.

One of the most important items to be considered at each renewal date would be the conclusion of the Commissioner's annual evaluation of the lending practices of the given institution or association, as to whether it is practicing any form of redlining. Of course, evidence on this point gathered by members of the public would be equally admissible to contest such an application.

An impact statement should also be required of any institution desiring to close an office. The Commissioner should require an institution to continue to serve a community through less-profitable times as a prerequisite to being awarded a license to operate in that community in the first place. Lenders cannot be permitted to drain off deposits from a community and then relocate elsewhere to more easily lend that money in a different neighborhood.

Banks also are subject to controls and the imposition of operating requirements, at the time they seek charters and licenses. The principal chartering control is contained in Section 401 of the Financial Code:

> "If the superintendent finds that the proposed bank or trust company has in good faith complied with all the requirements of law and <u>fulfilled all the conditions precedent to commencing</u>

> business imposed by this code or by regulation, he shall . . . issue in duplicate a certificate of authorization to transact business as a bank or trust company . . ."

The Superintendent can thus create regulations of the type discussed above for savings and loans, the requirements of which a charter applicant must promise to comply with. Furthermore, the Superintendent has the general power to turn down a charter application for an institution which is likely to act contrary to the public interest. Financial Code Section 503 states:

> "The superintendent may give or withhold his approval of an application in his discretion but he shall not approve an application . . . until he has ascertained to his satisfaction that the following are true:
>
> (a) That the public convenience and advantage will be promoted by the establishment of the proposed branch office . . . ."

The Superintendent's authority to reject branch applications is somewhat more limited, though under Section 504 of the Financial Code he does have the authority to specify for each new branch the "conditions under which it may be opened."

Unfortunately, in the case of bank applications, there does not exist the thorough hearing requirements which apply to savings and loans. This must be rectified by statute, rather than administratively. This does not prevent the Superintendent, however, from imposing the same requirements for the preapation of a Neighborhood Impact Statement, as we have recommended for savings and loans.

In all cases, for both savings and loans and banks, compliance with commitments made in the impact statements would be checked by the proposed Home Loan Investigative Agency.

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Redlining—The Fight Against Discrimination in Mortgage Lending

Introduction

On Saturday, June 22, 1974, forty residents of Chicago's southwest side assembled at the offices of a local savings and loan association to demand that the institution disclose information regarding its lending activities in the Chicago area for the preceding four years.[1] The disclosure demand was part of an effort to determine whether the association was "redlining" the area in which it was located by refusing to loan money for the purchase and improvement of homes in that area. This neighborhood is one of several Chicago neighborhoods where residential financing has been unavailable, causing residents to charge local financial institutions with redlining.

Pressure has also been exerted upon state and local governments to regulate mortgage lending practices. This pressure has not been without results. Allegations of redlining by Chicago area financial institutions[2] have resulted in the amendment of an ordinance[3] and

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1. Citizens Action Program Action, July, 1974, at 2, col. 4.
2. Although savings and loan associations are not the only source of residential financing, they are the primary source of such funds. At the end of 1973, savings and loan associations held 48.4 per cent of all loans on one to four family homes held by the private sector in the United States. This percentage excludes residential loans held by the United States government and federal agencies such as the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Farmers' Home Administration. The total value of mortgages held by the savings and loan associations was $186.8 billion as compared to $67.2 billion in mortgages held by commercial banks. United States League of Savings Associations, '74 Savings & Loan Fact Book 37-38 (1974).

Because of the predominance of savings and loan associations in the home financing field, this note will focus primarily upon redlining as practiced by state and federally chartered savings and loan associations.

Savings and loan associations have historically specialized in conventional loans rather than mortgages insured by the Federal Housing Authority or the Veterans Administration. At the end of 1973, conventional loans totalled 87.2 per cent of all mortgages financed by savings and loans. *Id.* at 78-79.

Because of the more favorable terms offered to borrowers by conventional rather than insured financing, the current furor over redlining in the Chicago area centers around the failure of financial institutions to grant conventional loans. Therefore, this note will be limited to a treatment of discrimination in the granting of conventional mortgages. For a thorough treatment of problems involved in loans insured by the Federal Housing Administration, see B. Boyer, Cities Destroyed For Cash (1973). In addition, see McClaughry, *The Troubled Dream: The Life and Times of Section 235 of the National Housing Act*, 6 Loyola U. Chi. L.J. 1 (1975).

the passage of a resolution[4] by the Chicago City Council, the promulgation of an anti-redlining regulation by the Illinois Commissioner of Savings and Loans,[5] introduction of remedial legislation in the state legislature,[6] and investigations of the problem by the Illinois Legislative Investigating Commission[7] and the Governor's Commission on Mortgage Practices.[8]

Definition of Redlining

The term redlining is derived from the practice of marking maps with red lines surrounding areas which are believed to present bad risks to mortgage lenders. This practice is not a new one and is not confined to private financial institutions. Since the period before World War II, the Federal Housing Administration has redlined certain areas.[9] Insurance companies also use this method of designating areas of a city in which insurance policies are available only at higher premiums.[10] Redlined areas are usually older city neighborhoods or suburbs, and are often areas which are changing in racial composition.[11]

Besides the refusal to grant mortgages in particular areas, redlining, consists of several more subtle practices. The terms of mortgages which are available may be less favorable than terms of mortgages in other areas. For example, mortgages in redlined areas are often available only at higher interest rates, for shorter terms, or with a requirement of a larger downpayment than those required for mortgages in purportedly more desirable areas. Some savings and loan associations which give mortgages on suburban property for downpayments of 5 per cent to 20 per cent require downpayments of 40 per cent in redlined areas.[12] Other lending institutions, adopting

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3. Chicago, Ill., Municipal Code ch. 7, §§ 7-30 to -40, *as amended*, June 26, 1974.
4. Chicago City Council Journal 8268 (May 29, 1974).
5. Ill. Savings and Loan Reg., art. VI, § 2 (1974).
6. S. 1386, 78th Ill. General Assembly (1973-74).
7. H.R. 753, 78th Ill. General Assembly (1974).
8. Ill. Exec. Order No. 4 (1974).
9. Chicago Sun Times, April 28, 1974, § 1-A, at 1, col. 1.
10. Illinois Legislative Investigating Commission Hearings on Redlining, Testimony of Brian Boyer, July 25, 1974, at 73 (transcript available at offices of Illinois Legislative Investigating Commission).
11. Phone conversation with Jordan H. Bodenstein, Counsel, Illinois Legislative Investigating Commission, Oct. 11, 1974. Two Chicago areas which have allegedly been redlined are Rogers Park and Austin. Illinois Legislative Investigating Commission, "Redlining" Alleged Discrimination in Home Improvement Loans 3 (1974).
12. Illinois Legislative Investigating Commission Hearings on Redlining, Testimony of Father Albin Ciciora, July 25, 1974, at 32-33.

the seemingly neutral criterion of building age as the sole basis for refusing to give mortgages, effectively make mortgages unavailable in older neighborhoods.[13]

Another aspect of redlining is the practice of giving forward commitments of mortgage money. Some savings and loan associations commit large sums of money for future mortgages on multi-million dollar subsidivisions. A developer is guaranteed that his customers will have access to mortgage money at attractive interest rates. In Cook County, Illinois, approximately two-thirds of available mortgage funds are committed to developers before mortgages for homes in the developers' subdivisions are actually requested, effectively placing that portion of the available mortgage money out of the reach of the individual who is seeking a mortgage on his own.[14]

The final aspect of redlining is the relocation of neighborhood banks and savings and loan associations out of the neighborhoods which they were chartered to serve, leaving no sources of mortgage money in the area. An institution may actually relocate or may establish a "branch" office in a more desirable neighborhood, later phasing out the original facility. One area on Chicago's west side, with a population of 300,000, was left without a local financial institution when the single neighborhood bank moved to downtown Chicago.[15] Federal regulations concerning branching and relocation of savings and loan associations emphasize the impact of the move upon the new areas to be served, but do not consider whether the move will adversely affect the institutions' original service areas.[16] State regulations on this point indicate a greater willingness to consider the impact of such a move on an association's original service area.[17]

Effects of Redlining

Redlined areas are generally those which are changing in racial

13. One Chicago savings and loan association informed a prospective home owner that he would be unable to get a mortgage on a forty year old house and that the association did not like to loan money on homes over 15 years old. *Id.* at 30.
14. Illinois Legislative Investigating Commission, Hearings on Redlining, Prepared Testimony of Mary Lou Wolff, President of Citizens' Action Program, August 1, 1974 (copy on file in Loyola Law Journal office).
15. Illinois Legislative Investigating Commission Hearings on Redlining, Testimony of Father Albin Ciciora, July 25, 1974, at 44.
16. 12 C.F.R. §§ 545.14(c), 545.16(b) (Supp. 1974). For further information about relocation of financial institutions out of redlined areas of Chicago, see Department of Housing and Urban Development, Administrative Meeting on Racial Discrimination in Lending, Testimony of Calvin P. Bradford, May 21, 1974 (copy on file in Loyola Law Journal office).
17. Ill. Savings and Loan Reg., art. X (1973).

composition or viewed as deteriorating.[18] The unavailability of mortgage money discourages new residents from moving into these areas. Older residents who are unable to obtain loans to improve their property may move elsewhere, selling their homes for less than the actual value of the property.

The availability of mortgage money is crucial to the vitality of a community. Because two-thirds to four-fifths of the cost of purchase or improvement of property is normally financed by borrowing,[19] the unavailability of such funds means that construction, purchase, and rehabilitation of existing homes cannot occur.

Lack of investment funds and its accompanying effect of discouraging new residents and businessmen from moving into a neighborhood places a burden upon local government. The shift of trade from neighborhood stores to suburban shopping centers reduces the city's sales tax revenue. The expense of providing services to city residents rises, and costly rehabilitation programs may be necessary.[20] Therefore, a savings and loan association's determination that an area is deteriorating may be a self-fulfilling prophecy.

The Federal Home Loan Bank Study

On February 21, 1974, the Federal Home Loan Bank of Chicago released a report summmarizing savings and lending data received in a survey of savings and loan associations serving the Chicago area.[21] The survey reported the total number and aggregate dollar amount of loans made between June 30, 1971 and June 30, 1973. Also reported were the number and aggregate amounts of savings deposits held by the institutions during this same period. The data were arranged by a zip code, but were not broken down by association.

Analysis of the Bank's report indicates that in heavily redlined areas of metropolitan Chicago, an average of four cents a year was reinvested in the neighborhoods for every dollar deposited. In less heavily redlined older neighborhoods of the city, an average of eight cents was reinvested for every dollar deposited. Investment in suburban areas was 31 cents per dollar of deposits. Whereas total lending by

18. *See* note 11 *supra.*
19. J. William Fredrickson, Professor of Economics, North Park College, Chicago, Illinois, Statement on Proposed Ordinance to Require Disclosure of Deposits and Investments by Depositary Financial Institutions (copy on file in Loyola Law Journal office).
20. *Id.*
21. Savings/Lending Survey of Chicago, Berwyn, Cicero, Dixmoor, Harvey, Hazelcrest, Homewood, Markham, and Oak Park, Federal Home Loan Bank of Chicago, 1974.

reporting associations rose by 11.1 per cent between 1972 and 1973, and lending in the newer suburbs increased by 12 per cent, investment fell as much as 64 per cent in some Chicago neighborhoods which savings and loan associations have allegedly redlined.[22]

This study does not present a true picture of the lending practices of Chicago area savings and loan associations. Sixty-two local associations with assets totaling $5,448,500,706 were excluded from the survey because they failed to respond to the questionnaire or responded incompletely.[23] In comparison, 127 participating associations had assets totaling $7,785,070,118.[24] These figures indicate that some of the area's larger associations were not included in the survey results. Furthermore, the information was not broken down by institution, making it impossible to ascertain the extent to which individual institutions were practicing discrimination in lending.

Self-Help Remedy for Redlined Communities

Because the directors of a mutually owned savings and loan association[25] are elected by its members,[26] it is theoretically possible for the members of an association which is redlining to nominate and elect directors who are committed to a change in the institution's lending policy.[27] Customers of a mutually owned savings and loan association—borrowers and savers—are members of the association with voting rights.[28] Such an association generally solicits a proxy from each member when a savings account is opened or when a loan is

22. Citizens Action Program Anti-Deterioration Coalition, Press Release, Feb. 28, 1974.

23. Federal Home Loan Bank of Chicago, News Dispatch, Feb. 21, 1974. Response to the survey was voluntary.

24. *Id.*

25. Eighty-eight per cent of all savings and loan associations in the United States are mutually owned. ABA Committee on Savings and Loan Associations, Section of Corporation Banking and Business Law, Handbook of Savings and Loan Law 12 (1973). All federally chartered savings and loan associations are mutually owned. 12 U.S.C. § 1464(b) (1973). Illinois law provides for capital stock and mutual associations. For a discussion of the differences between the two types of associations, see Handbook, *supra* at 12-14.

26. 12 C.F.R. § 544.1 (Supp. 1974); Ill. Rev. Stat. ch. 32, § 741(d) (1973).

27. Another method by which members of savings and loan associations have attempted to exert leverage over an association which is charged with redlining is to pledge that they will withdraw their savings if the associations do not change their lending policies. Citizens Action Program Action, July, 1974, at 4, col. 3.

28. Each member of a federally chartered savings and loan association is entitled to one vote per $100 of savings or fraction thereof on deposit. Each borrower is entitled to a single vote. No member may have over fifty votes. 12 C.F.R. § 544.1 (Supp. 1974).

Voting rights are the same under the Illinois Savings and Loan Act except that one vote is also granted to each holder of a permanent reserve share of a capital stock association. Ill. Rev. Stat. ch. 32, § 741(d) (1973).

transacted.[29] Directors of the association are elected by ballot of the members, usually at the association's annual meeting.[30]

A major obstacle for members attempting to exercise their voting rights in concert is the procedure which must be followed in solicitation of proxies. The Illinois Savings and Loan Act and the regulations of the Federal Home Loan Bank Board give each member the right to inspect an association's books only in so far as they pertain to his account.[31] This right is substantially more limited than the right of corporate shareholders in most jurisdictions to inspect corporate books and to copy a list of names and addresses of other shareholders in order to communicate with them about corporation business.[32]

If a member of an Illinois chartered savings and loan association wishes to communicate with fellow members, he must submit a copy of the proposed communication to the State Commissioner of Savings and Loan Associations for a determination that it is "appropriate and truthful."[33] The Commissioner may then direct the association to prepare and mail the communication to all of its members, at the expense of the requesting member.[34] One problem presented by this provision is that no member may inspect an association's records to determine if loans are being made in the neighborhood. Therefore, a communication which a member has submitted in good faith, and which charges an institution with refusal to lend in its neighborhood may be determined by the Commissioner to be untruthful.

Although there is authority that members of federally chartered savings and loan associations have a right to inspect and copy membership lists for the purpose of soliciting votes for an election of directors,[35] those associations may adopt a procedure which requires that

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29. Federal regulations require that all savings and loan associations, state or federal, which are insured by the Federal Savings and Loan Insurance Corporation provide members with a revocable proxy, labelled in boldface type and printed on a separate sheet of paper, when an account is opened or a loan transacted. 12 C.F.R. § 569.2 (Supp. 1974). In 1973, 97.2 per cent of the assets of all state and federally chartered associations were insured by the Federal Savings and Loan Insurance Corporation. UNITED STATE LEAGUE OF SAVINGS ASSOCIATIONS, '74 SAVINGS & LOAN FACT BOOK 122 (1974).

30. Directors of federally chartered associations are elected by ballot for terms of 3 years, with approximately one-third of the board elected each year. 12 C.F.R. § 544.1(a)(5), (b)(5) (Supp. 1974).

Directors of associations chartered by the State of Illinois are elected yearly. ILL. REV. STAT. ch. 32, § 744(b) (1973).

31. 12 C.F.R. § 544.6(g) (Supp. 1974), ILL. REV. STAT. ch. 32, § 748(a) (1973).

32. H. HENN, HANDBOOK OF THE LAW OF CORPORATIONS 395-402 (2d ed. 1970); ILL. REV. STAT. ch. 32, § 157.45 (1973).

33. ILL. REV. STAT. ch. 32, § 748(b) (1973).

34. *Id.*

35. Murphy v. Colonial Federal Savings and Loan Association, 388 F.2d 609 (2d

communications among members be prepared and mailed by the association.[36] According to this procedure, a member submits a proposed communication to the association's management for a determination that the subject matter is one which may be properly considered at a meeting of the association's members. If approved, the communication is then prepared and mailed, again at the expense of the member who submitted it.

In the only case to date construing the federal by-law,[37] plaintiffs were members of a local community organization who attempted to circumvent the procedure prescribed by the by-law for communication with other members. They claimed that the by-law was inadequate for their purposes because they wished to communicate personally with other members. The court granted plaintiffs' motion for summary judgment on the grounds that the Federal Home Loan Bank Board's regulation which permits savings and loan associations to adopt the by-law does not preempt the federal common law.[38] Judge Bauer remarked that the rights accorded an association's members by the by-law are substantially narrower than the rights accorded them by the common law. He therefore concluded that if the Federal Home Loan Bank Board had intended to limit members' rights of communication to those provided in the by-law, it would have so indicated. The court noted that plaintiffs had investigated the possibility of compliance with the by-law, and had found it too costly, but stated that even if the cost had been reasonable, plaintiffs' message could best be conveyed to their fellow members by face to face meetings. Similar decisions by other courts would appear to necessitate that the Federal Home Loan Bank Board clarify the purpose behind the optional by-law. For the moment, members of savings and loan associations which have adopted the by-law must follow the prescribed procedures unless they wish to challenge its provisions in court.

Besides following appropriate procedures for soliciting proxies from other members, those members of a savings and loan association

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Cir. 1967); Durnin v. Allentown Federal Savings and Loan Association, 218 F. Supp. 716 (E.D. Pa. 1963); Ochs v. Washington Heights Federal Savings and Loan Association, 17 N.Y.2d 82, 215 N.E.2d 485, 268 N.Y.S.2d 294 (1966).

36. 12 C.F.R. § 544.6(g) (Supp. 1974).

37. Kupiec v. Republic Federal Savings and Loan Association, Civil No. 74 C 378 (N.D. Ill. Oct. 3, 1974). The court had previously denied plaintiffs' motion for a preliminary injunction on the grounds that permitting members to inspect the books of the association might interfere with the ordinary conduct of association business and that plaintiffs' attempt to arrange a face to face meeting of the members might offend other members of the association and cause the association irreparable harm. Kupiec v. Republic Federal Savings and Loan Association, 373 F. Supp. 1382 (N.D. Ill. 1974).

38. See note 35 *supra*.

who attempt to wage a proxy fight should also ascertain whether the association has adopted either of two additional optional by-laws. One by-law requires that advance notice of candidates nominated for directors be given to the association's secretary.[39] The second by-law requires that the secretary be notified in advance of new business to be brought up at the association's annual meeting.[40] Care must be taken to meet the required deadlines if such by-laws have been adopted.

The utility of proxy solicitation as a tool for eliminating redlining from a community is greatly dependent upon the size and nature of the savings and loan association involved. Because no member can have more than fifty votes,[41] proxies must be solicited from a large percentage of the association's members. An association which has an exclusively neighborhood clientele is most likely to have a high percentage of members who are concerned with the association's lending policies in its immediate neighborhood. Even if the members fail to marshall enough votes to elect the directors they have nominated, a sufficient number of votes to demonstrate their strength to the institution's management may result in the slating of one of their candidates by the management in a future election.[42]

Existing Anti-Redlining Measures

Chicago's Solution—The Depositary Ordinance

On June 25, 1974, the Chicago City Council passed a Municipal Depositaries Ordinance.[43] The ordinance provided that a bank or savings and loan association[44] could not become a depositary of Chicago's city or school funds without signing an anti-redlining pledge and disclosing extensive information about its residential lending practices

39. 12 C.F.R. § 544.6(a) (Supp. 1974) provides for the nomination of directors by an appointed committee. Other nominations must be delivered to the secretary of the association at least 10 days prior to the annual meeting.

40. 12 C.F.R. § 544.6(b) (Supp. 1974) requires that new business to be discussed at the annual meeting be filed with the association's secretary at least 30 days prior to the annual meeting.

41. 12 C.F.R. § 544.1 (Supp. 1974); Ill. Rev. Stat. ch. 32, § 741(d) (1973).

42. Although plaintiffs in *Kupiec* had only 11,000 votes within their control at the annual meeting, compared to the 300,000 votes in the hands of the association's proxy committee, the association management indicated that it was considering including some neighborhood residents in its next slate for board of directors. Marshall, *Mortgage Redlining*, Savings and Loan News, June, 1974, at 51.

43. Chicago, Ill., Municipal Code ch. 7, §§ 7-30 to -40, *as amended* June 26, 1974.

44. This is the first time that savings and loan associations have been permitted to be depositaries of city funds. This is particularly important because it will provide additional money to be loaned as mortgages. Illinois Legislative Investigating Commission, Hearings on Redlining, Prepared Testimony of Alderman Dick Simpson, August 1, 1974 (copy on file in Loyola Law Journal office).

within the previous calendar year. The information was originally required to be broken down according to census tract.

When bids were opened to 199 eligible financial institutions on August 12, 1974, only three institutions bid for the city funds.[45] Because several banks and savings and loan associations had indicated that they would be unable to compile the required information within the allotted time, the City Council retrenched and modified the ordinance at its August 21 meeting.[46] The disclosure requirement and pledge were postponed to 1975. Whereas, the original ordinance required that lending data be disclosed by census tract, the revised ordinance permits 1975 lending data to be compiled by zip code or by census tract, requiring disclosure by census tract to begin in 1976. The effectiveness of this ordinance in discouraging redlining will not be measurable until the results of the 1975 and 1976 bidding are available.

A depositary bill was also considered by a committee of the Illinois State Legislature.[47] The proposed state legislation was unsatisfactory in that it consisted of an anti-redlining pledge[48] without requiring disclosure of lending data. Although compliance with such depositary laws is purely voluntary, the use of governmental funds may prove to be an attractive incentive to discontinue redlining during the current "credit crunch." When the credit crunch has subsided, however, it is likely that the effectiveness of depositary laws will be reduced. Because of its voluntary nature, this type of statute does not present the pre-emption problems which arise when a state government attempts to regulate federally chartered savings and loan associations.[49]

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45. Chicago Daily News, Aug. 20, 1974, at 16, col. 5. Those three institutions could legally receive only $7 million of the city's funds. Only those institutions whose funds are insured by the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation can become depositaries. CHICAGO, ILL., MUNICIPAL CODE ch. 7, § 7-30 (1974), *as amended* June 26, 1974.

46. CHICAGO, ILL., MUNICIPAL CODE ch. 7, §§ 7-34, 7-34.1, *as amended*, Aug. 21, 1974.

47. S. 1386, Ill. 78th General Assembly (1973-74). According to a telephone conversation with the bill's sponsor, Senator Harold Nudelman, on September 19, 1974, the bill remained in executive committee and must be re-introduced at the next session of the legislature.

48. The anti-redlining pledge was essentially the same as that required by the Chicago ordinance.

49. Courts have consistently held that regulation of federal savings and loan associations has been vested solely in the Federal Home Loan Bank Board and that such institutions are not subject to state laws relating to the regulation of savings and loan associations. *See* People, Etc. v. Coast Federal Savings and Loan Association, 98 F. Supp. 311 (S.D. Cal. 1951); Springfield Institution v. Worcester Federal Savings and Loan Association, 329 Mass. 184, 107 N.E.2d 315 (1952).

The Illinois Regulation

On January 17, 1974, the Illinois Savings and Loan Commissioner promulgated a regulation prohibiting Illinois chartered savings and loan associations from varying the terms of mortgages because of the geographic location of the proposed collateral.[50] Illinois thus became the first state in the United States to enact a statute or administrative regulation prohibiting the practice of redlining.[51] On closer scrutiny, the regulation appears to be an exercise in futility.

The regulation requires that all Illinois savings and loans maintain records of loan applications which have been approved.[52] Further, the Commissioner of Savings and Loans is empowered to require that a savings and loan association also retain records of rejected loan applications[53] for a period of two years.[54] The Commissioner may also require that the records of rejected loans be submitted to him.[55] It was intended that the Commissioner would impose the additional record keeping requirement upon those associations which had been charged with redlining.[56] To date only a handful of complaints have been received, and the Commissioner has determined that none of these allegations require further inquiry into the lending policies of the associations in question.[57]

The Illinois anti-redlining regulation, which is dependent upon complaints by individuals whose loan applications have been rejected, presents the risk of random enforcement. It is unlikely that many citizens will take the trouble to report instances of redlining to the Commissioner of Savings and Loans because he lacks the power to provide them with mortgage money. A more effective system would be one in which all state chartered savings and loans were required to maintain records of rejected mortgage applications. These records could be periodically reviewed by the Commissioner's staff. This review could be conducted concurrently with the yearly examination which the Commissioner is required to make of the books of each Illinois chartered savings and loan association.[58]

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50. Ill. Savings and Loan Reg. art. VI, § 2 (1974).
51. September 27, 1974 telephone conversation with Daniel P. Lynch, Examiner, Consumer Division, Office of the Illinois Commissioner of Savings and Loans.
52. Ill. Savings and Loan Reg. art. IV, § 3(b)(1) (1974).
53. *Id.* art. VI, § 2(b).
54. *Id.* art. IV, § 3(b)(2).
55. *Id.* art. VI, § 2(b).
56. September 27. 1974 telephone conversation with Daniel P. Lynch, Examiner, Consumer Division, Office of the Illinois Commissioner of Savings and Loans.
57. *Id.*
58. ILL. REV. STAT. ch. 32, § 842 (1973).

The Illinois regulations provide that a presumption of discrimination shall attach to a rejection of a mortgage loan which is unsupported by documentation which indicates that sound underwriting practices were used.[59] Because savings and loan associations are not required to retain records of rejected loan applications until after a complaint is received, the Commissioner may be unable to determine the basis for the rejection of a complainant's application. It is unlikely that an association which has been charged with redlining and required to retain rejected loan applications would openly continue its discriminatory lending practices. Therefore, few, if any, charges of redlining will be substantiated under this regulatory scheme.

The anti-discriminatory regulations are silent with regard to sanctions applicable to savings and loan associations which engage in redlining. The Illinois Commissioner of Savings and Loans is empowered to institute a law suit to enforce state laws which are applicable to state chartered savings and loan associations.[60] He may apparently follow the same procedure to enforce regulations which have been promulgated for the purpose of implementing the Illinois Savings and Loan Act. However, the poor response to the regulations by mortgage applicants and the difficulty of determining why a loan application was rejected render it unlikely that a charge of redlining will ever reach this stage.

The Federal Home Loan Bank Board Regulations

On April 21, 1972, the Federal Home Loan Bank Board adopted a regulation prohibiting discriminatory lending practices:

> No member institution shall deny a loan or other service rendered by the member institution for the purpose of purchasing, constructing, improving, repairing or maintaining a dwelling . . . because of the race, color, religion, or national origin of
>
> (a) An applicant for any such loan or any other service rendered by the member institution;
>
> (b) Any person associated with such applicant in connection with such loan or other service or the purposes of such loan or other service;
>
> (c) The present or prospective owners, lessees, tenants, or occupants of the dwelling or dwellings in relation to which such loan or other service is to be made or given; or
>
> (d) The present or prospective owners, lessees, tenants, or

59. Ill. Savings and Loan Reg. art. VI, § 2(c) (1974).
60. Ill. Rev. Stat. ch. 32, § 841.2(c) (1973).

> occupants of other dwellings in the vicinity of the dwelling or dwellings in relation to which such loan or other service is to be made or given.[61]

In an opinion letter dated March 21, 1974,[62] the general counsel of the Federal Home Loan Bank Board indicated that, based on cases under Title VII of the Civil Rights Act of 1964[63] and cases under Title VIII of the Civil Rights Act of 1968,[64] lending practices which are discriminatory in effect violate the anti-discrimination regulations regardless of the intent of the lender. Further analogizing from cases under the Civil Rights Acts, he indicated that statistical evidence which demonstrates a clear pattern of discrimination establishes a prima facie case of violation of the regulations, shifting to the defendant the burden of proof that discrimination is not being practiced. Noting that a genuine business purpose has been a defense to findings of discriminatory effect in cases under the Civil Rights Acts, he continued:

> There is substantial legal precedent for the Board to presume that redlining that is discriminatory in effect is unlawful (without any countervailing business purpose) and to shift the burden to the institution to demonstrate some reasonable genuine business purpose for redlining. In any case, such a business necessity would not be established by the institution's unsubstantiated belief that no profitable loans could be made in a given area.[65]

While the federal regulations do not specifically prohibit redlining, they clearly indicate that redlining which has the effect of discriminating against any of the groups enumerated would constitute a violation of the regulations.

In order to protect those victims of redlining who are not members of the enumerated groups, the regulations would have to be expanded to include a prohibition against discrimination in residential financing which is based on the area in which the property is located. The regulations have been interpreted by the Federal Home Loan Bank Board to prohibit discrimination based on age, sex, and marital status of the potential borrower, on the rationale that such discrimination would impede the objective of promoting fair housing opportunity for all Americans.[66] The same objective would be promoted by expand-

61. 12 C.F.R. § 528.2 (Supp. 1974).
62. 2 U.S. League of Savings Associations Federal Guide 8173-3, ¶ U 13-49.2 (1974).
63. 42 U.S.C. § 2000e (1964).
64. 42 U.S.C. § 3601 (1968).
65. 2 U.S. League of Savings Associations Federal Guide 8173-3, ¶ U 13-49.2 at 8173-6 (1974).
66. 12 C.F.R. § 531(8) (Supp. 1974).

ing the regulation to protect those individuals who are unable to finance their housing solely because of the areas in which they have chosen to live. Such a regulation would also be consonant with the purpose of providing for financing of homes by local institutions, a purpose which Congress expressed in authorizing the Federal Home Loan Bank Board to charter and regulate savings and loan associations.[67]

The Federal Home Loan Bank Board has already instituted a record-keeping requirement which includes information on the location, by census tract or zip code, of the property which an applicant wishes to purchase or improve with the loan for which he has applied.[68] Though the Bank is seeking information as to the racial, ethnic, or religious affiliation of loan applicants, the data can also be used to ascertain whether an institution has established a pattern of refusing to loan mortgage money in a particular geographic area. Unlike the Illinois regulation, this record-keeping requirement applies to all financial institutions, and to all loan applications, whether or not they have been accepted. More significantly, the federal non-discrimination regulation and record-keeping requirement apply to all Federal Home Loan Bank members,[69] whether they are chartered by the federal government or by a state government.[70] Therefore, the regulation applies to state and federally chartered institutions. Because savings and loan associations belonging to the Federal Home Loan Bank System hold 97.7 per cent of all the assets in the savings and loan business,[71] the regulation, if amended to prohibit redlining, will have a far-reaching effect. Because the record-keeping requirement is still being tested in several areas of the country, it is impossible to ascertain what

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67. The relevant statutory provision states:

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal Savings and Loan Associations," and to issue charters therefore, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.

12 U.S.C. § 1464(a) (1973).

68. 39 Fed. Reg. 18642 (1974).

69. 12 C.F.R. § 528.2 (Supp. 1974) provides that the federal non-discrimination regulation shall apply to all institutions which are members of a Federal Home Loan Bank. In 12 C.F.R. § 528.1 (Supp. 1974), the term "member institutions" is defined as all members except savings banks insured by the Federal Deposit Insurance Corporation, insurance companies, and the Federal Home Loan Mortgage Corporation.

70. Membership in the Federal Home Loan Bank is required of federally chartered savings and loan associations and optional for associations chartered by states. 12 U.S.C. § 1464(f) (1973).

71. United States League of Savings Associations, '74 Savings & Loan Fact Book 112 (1974).

steps the Home Loan Bank Board will take when a violation of the regulation becomes apparent.[72]

The success of the Federal Home Loan Bank Board in identifying discrimination by member institutions will not necessarily alleviate the major consequence of redlining—the unavailability or shortage of mortgage money in particular geographic areas. This aspect of the problem can only be solved by a program which, in addition to identifying institutions which discriminate, provides a source of money for those unable to obtain financing. The various means by which government can insure that such monies will be provided are discussed in the following section concerning potential state legislation. Similar legislation could be adopted on the federal level.

Proposals for Illinois Legislation

Study of the redlining problem by two state commissions[73] indicates that remedial legislation will be introduced in the Illinois General Assembly in the near future. Any attempt by the state to regulate federally chartered savings and loan associations will encounter difficulties because the field of regulation of the federal associations has been pre-empted by the Federal Home Loan Bank Board.[74]

In order to determine the extent of redlining in Illinois and to evaluate the effectiveness of any remedial measures adopted, savings and loan associations must be required to keep records of all loan applications. The Federal Home Loan Bank Board has already instituted such a requirement in the Chicago area.[75] Accordingly, such information is already available for members of the Chicago Home Loan Bank. Similar information can be obtained for non-members by expansion of the disclosure regulations promulgated by the Illinois Commissioner of Savings and Loans.[76] Further, public disclosure of each association's lending practices according to geographic area would

72. A pilot program requiring that three different types of forms be filled out when loan applications are made, in three different groups of cities, was instituted on June 1, 1974 to continue for 6 months. This is part of an attempt to coordinate the Home Loan Bank Board's effort with similar record-keeping requirements to be implemented by the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Comptroller of the Currency. These forms will be analyzed so that each agency can determine which form best serves its purposes and whether a coordinated effort should be continued. Chicago is part of this pilot project. Federal Home Loan Bank Board, Release 74-224 (March 22, 1974), 39 Fed. Reg. 18642 (1974).

73. Redlining is being studied by the Illinois Legislative Investigating Commission, H.R. 753, 78th Ill. General Assembly (1974) and the Governor's Commission on Mortgage Practices, Ill. Exec. Order No. 4 (1974).

74. *See* note 49 *supra*.

75. 39 Fed. Reg. 18642 (1974). See text accompanying note 71 *supra*.

76. Ill. Savings and Loan Reg. art. VI, § 2 (1974).

fected by a lowered state reserve requirement.

Direct State Involvement in Granting Mortgages and Mortgage Insurance

The State of Illinois could become directly involved in combatting redlining either as a:

(1) Direct lender or

(2) An insurer of privately financed mortgages.

This would benefit prospective mortgagors who have been victims of redlining by enabling them to obtain financing.

Availability of state funds to those persons who have attempted to find residential financing and have been unsuccessful would offer an incentive to citizens to report instances of redlining to the state, thereby facilitating the enforcement of the Illinois anti-redlining regulation.[80] Alternatively, direct state loans could be made generally available in redlined areas.

A variation of direct loans funded by the state has been instituted by the Illinois Housing Development Authority.[81] Under that program, $22.9 million in mortgage money has been made available to 20 of Chicago's financial institutions. The institutions must match the money with their own funds. Funded by tax-exempt securities, this "loan to lenders" program is an attempt to place new mortgage money in redlined areas of Chicago.[82]

A state program of mortgage insurance would face the same problems encountered by the Federal Housing Administration in its mortgage insurance programs.[83] Insured mortgages provide incentives for mortgagees to foreclose. This is particularily true if the insurer pays the cost of foreclosure.[84] While conventional lenders frequently go to great lengths to avoid foreclosure, allowing mortgagors to be as many as ten months delinquent in their payments, Federal Housing Authority insured mortgages are often foreclosed if payments are 30 days overdue.[85] Upon foreclosure, the insurer reimburses the mort-

80. Ill. Savings and Loan Reg. art. VI, § 2 (1974).
81. The Illinois General Assembly created the Illinois Housing Development Authority in 1967. ILL. REV. STAT. ch. 67½, § 301 (1973).
82. Chicago Real Estate Advertiser, June 21, 1974, at 1, col. 3.
83. For a thorough treatment of the problems involved in the administration of insured mortgages through the Federal Housing Administration, see B. BOYER, CITIES DESTROYED FOR CASH (1973) and McClaughry, *The Troubled Dream: The Life and Times of Section 235 of the National Housing Act*, 6 LOYOLA U. CHI. L.J. 1 (1975).
84. Illinois Legislative Investigating Commission Hearings on Redlining, Testimony of John Waner, August 1, 1974, at 93.
85. *Id.* at 88-92.

gagee for the amount invested in the mortgage.

A better alternative would be an insurance program which insures the mortgagor against the inability to meet his mortgage payments. This would offer no incentive to the mortgagee to foreclose. Both types of insurance, however, suffer from the defect of encouraging savings and loans to be less prudent in evaluating the prospective mortgagor's financial standing than if the application had been for a conventional loan.

State Regulation of Savings and Loan Associations

State regulation of mortgaging practices of savings and loan associations would include:

(1) Periodic renewal of the charters of Illinois savings and loan associations contingent upon proof that they do not practice redlining;

(2) Refusal to allow Illinois savings and loan associations to relocate or branch if such actions would deprive their original neighborhoods of needed mortgage money;

(3) A requirement that associations institute affirmative lending programs; and

(4) The creation of an assigned risk mortgage pool.

This type of regulation would be inapplicable to federally chartered associations,[86] although similar provisions could be adopted by the Federal Home Loan Bank Board.

Periodic renewal of charters, conditioned on proof of non-discriminatory lending practices, would require identification of redlined areas and development of standards regarding the amount of mortgage money an institution should be lending in a particular area. Similarly, statistical data would be necessary to administer a program which conditions branching and relocation of associations on the availability of mortgage money in the association's original service area. The effect of either type of legislation would be limited to state chartered institutions. Finally, both of these proposals would require that small neighborhood savings and loan associations bear whatever financial risks are attendant upon lending in redlined areas, possibly endangering the security of their members' savings deposits.

In addition, the state could require savings and loan associations to adopt affirmative lending programs. Such programs would, of course,

86. *See* note 49 *supra*.

be limited by the general availability of mortgage money. Under this plan, associations would be required to seek out mortgagors in their communities and even advertise the availability of funds for neighborhood mortgages. While this type of program would contribute to the revitalization of redlined areas by encouraging people to purchase homes there, it suffers from the disadvantage of placing a burden on neighborhood savings and loan associations. As in the case of the two preceding legislative proposals, adoption of this alternative would require the identification of redlined areas and the formulation of standards to evaluate the adequacy of each association's lending performance in those areas. Such procedures would further delay the availability of mortgage money to victims of redlining.

Finally, the best alternative in this category of legislation is the creation of an assigned risk mortgage pool to be administered by the state.[87] This type of plan would allocate the risk of lending in redlined areas among all the savings and loan associations in a particular county. Mortgages would be granted to those individuals who had been refused funding by three or more institutions because of the location of the property they wished to purchase. Associations would be required to participate in varying degrees, depending upon the total amount of their assets. The financial burden would thus be removed from small, neighborhood associations located in redlined areas.

To insure that participating associations do not falsify the credit rating of the mortgagor or the condition of the collateral in order to avoid lending in redlined areas, state supervision of the appraisal of collateral and the evaluation of mortgagors is essential. Because persons desiring mortgages from the pool would have to report redlining to the state agency administering the program, creation of an assigned risk mortgage pool would have the incidental effect of aiding enforcement of the state's anti-redlining regulation.

The most effective type of state remedy for redlining is either an assigned risk mortgage pool or a program in which the state acts as a mortgagee. In either case, individuals who have been victims of redlining would be provided with an immediate source of mortgage money. The availability of mortgage funds would tend to encourage

87. Illinois has adopted a similar assigned risk plan to provide automobile insurance for those persons who are considered to present such high risks that they are unable to obtain automobile insurance. ILL. REV. STAT. ch. 95½, § 7-501 (1973). The Chicago City Council adopted a resolution recommending that the State of Illinois create an assigned risk mortgage pool. CHICAGO CITY COUNCIL JOURNAL 8268 (May 29, 1974).

the purchase and rehabilitation of homes in city neighborhoods, helping to reverse the effects of redlining. Both types of legislation would effectively combat redlining by state chartered associations if coupled with a strengthened state anti-redlining regulation which includes a requirement that all state savings and loan associations maintain records of all loan applications. However, the state's inability to regulate federally chartered savings and loan associations underscores the need for state legislation which provides mortgage money for home purchasers, and offers relief to victims of redlining, whether they have been refused financing by state or federally chartered associations.

Conclusion

Just as Americans are concerned about recycling cans and bottles, the time is ripe for a program which recycles urban neighborhoods. The continued unavailability of mortgage money for the purchase and rehabilitation of homes in those neighborhoods contributes to the flight to the suburbs. If this trend is not reversed, many populated urban areas may ultimately be reduced to blocks of abandoned buildings which will become habitable only at great expense. To avoid this eventuality, mortgage money must be made available in redlined areas. To date, attempts to control redlining have proven inadequate. In order to reverse the flow of mortgage money out of redlined neighborhoods, governmental priorities must be re-evaluated and a commitment made to encourage and assist individuals wishing to purchase or improve homes in those urban areas.

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